United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL 74-2233

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IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

DOCKET NO. 74-2233

In the Matter of

CONTINENTAL VENDING MACHINE CORP.
and CONTINENTAL APCO, INC.,

Debtors.

JAMES TALCOTT, INC.,

Appellant,

IRVING L. WHARTON,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK, JACOB MISHLER, CH. J.

APPELLANT'S REPLY BRIEF

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4

INDEX TO BRIEF

Argument

TABLE OF CASES

Page

TEXTS

STATUTES

I - TALCOTT'S RETENTION OF THE "SURPLUS" AS SECURITY FOR DEBTS SPECIFIED IN THE AGREEMENTS HAS BEEN LAWFUL AND PROPER WITH NO OBLIGATION TO RETURN IT.

The agreements provide:

* * * *

"2. You (Talcott) shall be entitled to hold all sums and all property of the undersigned (Debtors) at any time to its credit or in your possession or upon or in which you may have a lien or security interest as security for any and all obligations of the undersigned at any time owing to you * * no matter how or when arising and whether under this or any agreement or otherwise,* * *. Subject to the provisions of this agreement, at the request of the undersigned, and at any time in your sole discretion you may remit any monies standing to the credit of the undersigned on your books. * *

* * * *

The agreements further provide that upon breach or termination, the debtors shall become obligated for

"7. * * * all costs and expenses incurred, including a reasonable allowance for attorney's fee, to obtain or enforce payment of any receivable assigned or of any obligations of the undersigned to you, or in the prosecution or defense of any action or proceeding either against you or against the undersigned concerning any matter growing out of or connected with this agreement and/or the receivables assigned or any obligations of the undersigned to you; * * *

Paragraph 7 then provides for liquidation of the security and

" * * . The proceeds * * shall be applied first to all costs and expenses of sale including attorneys' fees and second to the payment of all of the obligations or liabilities * *,

whether due or to become due, and whether arising under this agreement or otherwise, returning the overplus, if any, to the undersigned who shall remain liable to you for any deficiency."

Reading paragraphs 2 and 7 together, the security and, on liquidation, its proceeds covered (1) debts for loans and advances, (2) debts for liquidation costs, expenses and attorney's fees and (3) debts under the dragnet clause in both paragraphs.

When liquidation of the security was completed in 1964, debts (1) for loans and advances were determined by Talcott and charged against the proceeds. Debts (2) for liquidation costs and expenses embracing auditing, non-legal collection and miscellaneous charges and some of the attorney's fees were also determined by Talcott and in due course charged against the proceeds.

However, the full amount of attorney's fees to be charged against the proceeds is not known. At the hearings on Talcott's proof of claim for its costs and expenses, Talcott's Brief 13 (Tal B), attorney's services and billings have been brought up to January 1, 1974. Additional services have been rendered since and they will continue for an indeterminate future. The fees for these additional services cannot be determined and the proceeds of the security remain subject to them.

Also subject to the security proceeds are debts (3) under the dragnet clause, which Talcott has since identified as the debts of Continental, subject to the determination of this appeal.

The trustee points to the last clause of paragraph 7 which obligates Talcott to return "the overplus, if any", Trustee's Brief 20 (TB). Normally, such obligation exists even without express agreement. Cass v. Higenbotan, 100 N.Y. 247 (1885); U. S. v. Philips, 267 F.2d 374, 377 (5 Cir. 1959) (TB18).

There is no "overplus" until all debts for which the security is given are fully satisfied. Jackson v. American Cigar Box Co., 141 App. Div. 195, 197, 126 N.Y.S. 58 (1st Dept. 1910). Only debts (1) for loans and advances, as determined by Talcott, have been fully satisfied.

The word "surplus" has been used loosely by the parties and by the court to define the disputed fund. The trustee is very much mistaken in treating as a paragraph 7 "overplus" the security proceeds remaining after satisfaction of debts (1) for loans and advances and partial satisfaction of debts (2) for costs and expenses. The remaining proceeds constitute only tentative, possible, potential "overplus" which Talcott had and has every right to keep until final resolution of the disputes

over them. The fund is clearly not that completely free equity for the debtors to which the trustee is entitled.

In fact the trustee, while contesting Talcott's right to the remaining proceeds, has never made an outright demand for their return. On the contrary, he acquiesced and impliedly consented to Talcott's continued possession by agreeing to an arrangement for Talcott to credit the trustee with interest on the fund and debit him with interest on the Continental deficiency - interest "on both sides of the ledger" (Record Document 11, p. 24).

The trustee refers (TB 18) to Section 9-404, New York Uniform Commercial Code (McKinney's Consolidated Laws, v. 62-1/2, part 3, p. 582):

> "Whenever there is no outstanding secured obligation and no commitment to make advances; incur obligations or otherwise give value, the secured party must on written demand by the debtor send the debtor a statement that he no longer claims a security interest under the financing statement * * *."

The Code "applies to transactions entered into and events occurring on and after the effective date * * September 27, 1964". Id. Section 10-101, p. 645. Assuming, without conceding, the Code is applicable, had the trustee made a Section 9-404 demand, Talcott would have refused to comply upon justified denials: that "there is no outstanding secured obligation" and that it "no longer claims a security interest under

the financing statement". Failure to demand may properly be evidence that the security interest was to continue beyond the original obligation. Anderson, Uniform Commercial Code (2d ed.) vol. 4, Section 90504:5, p. 545,citing persuasive dictum in Safe Deposit Bank & Trust Co. v. Berman, 393 F.2d 401, 403 (1 Cir. 1968).

Contrary to the trustee's belief (TB21), had Talcott improvidently returned the remaining proceeds before all debts secured thereby have been ascertained, validated and paid, Talcott would have had a right to restitution for mistake of law or fact. Albert v. Martin Custom Made Tires Corp., 116 F.2d 962, 964-965 (2 Cir. 1941); Standard Oil of N.J. v. U. S., 121 F. Supp. 770, 773-774.

The trustee has contended that the remaining proceeds must be applied in partial satisfaction of Apco's debts underlying the trustee's certificates (497 F.2d at 821, Tal B 13). There was thus never any question of Talcott's right to possession. The dispute related only to the fund's proper application.

By the above contention the trustee denies that even debts (1) for loans and advances have been paid in full. And this particular dispute brings us willy nilly into the pending accounting. True enough, no accounting issues are "present on

this appeal" (TB 18). Yet the accounting issues bring starkly to the fore the utter futility of the trustee's argument that "Talcott should have paid over the Apco surplus years ago." (TB 21).

II - CONSOLIDATION AND THE BROAD DRAGNET CLAUSE AFFORD TALCOTT A LIEN UPON THE "SURPLUS" LAWFULLY IN ITS POSSESSION.

Conspicuously absent from the trustee's argument is the indispensable consideration of the language in the dragnet clause. (Tal B 18) The trustee is content to rely on the conceded absence in the agreement of a cross-collateralization clause (TB 18) without explaining why, upon consolidation, the dragnet clause is not broad enough to accomplish the purpose of cross-collateralization. (Tal B 18-20, 22-23)

The trustee does cite In re Quilting Co., Inc., CCH Dec. #62,007 (S.D.N.Y. 1966) (TB 19) holding that the provision in a factoring agreement securing "any indebtedness owing by you to us under this agreement or otherwise" is ambiguous. In the absence of proof of intent, the Referee denied the factor a set-off of an equity it held in favor of the debtor against the debtor's indebtedness to a supplier, also the factor's client. There was lacking the requisite mutuality of debts between the factor and the debtor, the Referee held, to permit a set-off under section 68

of the Bankruptcy Act. The case is distinguishable on at least two counts: the language of the agreement and no piercing the veil.

The debts secured in that case are those "under this agreement or otherwise." The clause in the instant case is infinitely broader: the debts secured are those "under this agreement", but also debts "no matter how and when arising and whether * * under any agreement or otherwise." And there is simply no ambiguity in "otherwise". (Tal B 18-20)

If the debtor in that case and its supplier were consolidated or if their interrelationship allowed for piercing their veils, absence of a tripartite agreement relating to their respective debts to the factor would not have precluded a section 68 set-off. This follows from the Referee's reference to In re Berger Steel Co., Inc., 327 F.2d 401 (7 Cir. 1964). For the want of a tripartite agreement between parent, subsidiary and creditor in that case, a set-off was also disallowed. However, the question of piercing the veil was presented but rejected for insufficiency of proof. It was "found that Inland and Ryerson were separate corporate entities and that there was no basis for disregarding those entities.", 327 F.2d at 404. By necessary inference, if sufficient proof had existed for

disregarding the entities in <u>Berger</u> and in <u>Independent Quilting</u>, a section 68 set-off would have been allowed.

The debts of Continental are the debts of Apco. In <u>Page v. Arkansas Natural Gas Corp.</u>, 33 F.2d 27 (8 Cir.) affirmed on other grounds, 286 U.S. 269 (1932), common law business trusts were equated with corporations and the separateness of two legal entities was disregarded by their conduct before bankruptcy. Their properties were administered as one in the bankruptcy proceedings and the debts of both were paid on an equal footing out of the common pot. All this was done on the basis of "an implied merger, which has been defined as a confusion of rights.", 33 F.2d at 38.

The <u>Page</u> formulation supports Talcott's assertion that the findings in this case serve only to establish judicially pre-petition facts operative to invoke the instrumentality rule. (Tal B 23) The debtors' abuse and misuse of the corporate privilege worked an implied pre-petition merger of the two debtors and a "confusion of rights" which merged their assets and liabilities. Continental and Apco came into the reorganization court as impliedly merged entities and, by the findings and consolidation, the court, as in <u>Page</u>, merely confirmed the existing merger.

The resultant oneness of the entities, their assets and their debts is illustrated by Trustees System Co. of Pennsylvania v. Payne, 65 F.2d 103 (3 Cir. 1933). Creditors of a parent corporation sought appointment of receivers for five subsidiaries. The question presented was whether they had standing as creditors of the subsidiaries. They argued that they had under the instrumentality rule. The court sustained them. 65 F.2d at 108:

> "The validity of the averment turns on the question we have decided whether the Pennsylvania group of corporations had maintained or lost their separate entities. Having found that they had not maintained them, the plaintiffs' character of creditors of the parent corporation extends to the corporate departments or agencies which it embraced."

In Fitzgerald v. The Central Bank & Trust Company, 257 F.2d 118 (10 Cir. 1958), the bank (Talcott) took a mortgage upon property of a corporation (Apco) for a loan found to have been made to its dominant officer's sales company (Continental). The bank filed a secured claim against the bankrupt corporation. The trustee objected upon the ground that the claim represented an obligation of the officer's sales company, not of the bankrupt corporation. The objection was overruled. Part of the claim was paid out of proceeds of the mortgaged property. For the deficiency a general claim was allowed. Upon the facts in the case, the court pierced the veil, applied the instrumentality rule and concluded, "the claim of the bank * * should be treated as the debt of both." 257 F.2d at 121.

Absence of a finding that debts of Continental are debts of Apco (TB 17) or that the assets of one are the assets of the other is of no significance. No such finding is necessary, the result is brought about by operation of law. The plan provides for treatment of the debtors' properties "on the basis of a merger or consolidation" and of general claims "on a consolidated basis." (36a) The order approving the plan finds that "the assets and liabilities of Continental and Apco should be merged and consolidated." (41a) No other finding is needed to support interchangeable ownership of assets and interchangeable liability for debts.

Exulting form over substance, the trustee stresses absence of formal merger and consolidation. He denies joinder of the two entities into one as a consequence of the plan and points to the provision for separate formal dissolution when distribution is completed. (TB 22) Where as here a corporation is completely liquidated with no intention to resume business and its franchise is unused for many years, the empty shell is deprived of corporate existence and the corporation is treated as dissolved de facto. U. S. v. Playa De Flor Land & Imp. Co., 160 F.2d 131, 134 (Canal Zone Cir. 1947); ABC Brewing Corp. v. C.I.R., 224 F2d 483, 488 (9 Cir. 1955); Stonybrook Tenants Ass'n., Inc. v. Alpert, 194 F. Supp. 552, 559, footnote 5 (D. Conn. 1961).

In secured transactions application of the instrumentality rule is not conditioned solely on shifting the collateral without knowledge of the secured creditor. Nor is it restricted to cases where the creditor holds security of both debtors. Cf. Cattle Owners Corp. v. Arkin, 267 F. Supp. 658 (D. Iowa 1967) (TB 36-37). Where, as in the case at bar, the security is the property of one debtor and the debt is owed by the other debtor by application of the instrumentality rule, the security of one covers the debt of the other. Fitzgerald v. The Central Bank & Trust Company, supra.

Nor is application of the instrumentality rule conditioned solely on mistreatment of the subsidiary to the benefit of the parent. Cf. Anaconda Bldg. Materials Co. v. Newland, 336 F.2d 625 (9 Cir. 1964)(TB 37-38).

Shifting of collateral, mistreatment of subsidiary by parent and a host of similar considerations in an endless variety of contexts may indeed be pertinent to a determination of whether there should be a consolidation. The question here is whether consolidation already decreed merges the debtors' identities, their assets and their liabilities. If it does, the question then is whether the particular dragnet clause in this case extends the security of a subsidiary to the debts of the parent. An affirmative answer is believed to be inescapable.

III - ASSUMING EQUITABLE POWER TO EXCLUDE A CREDITOR FROM CONSOLIDATION FOR JUST CAUSE, THERE IS NO POWER TO DEPRIVE TALCOTT OF A VALID LIEN AND IN ANY EVENT TALCOTT'S EQUITIES HAVE NOT BEEN EXPLORED.

The trustee urges that a court of equity may with perfect consistency pierce the corporate veil in one instance and hold it up in another. (TB 26-27) This is valid enough if properly confined within the strict limits of the decisions upon which the trustee relies.

In Pittsburgh Railways Co., 155 F.2d 477 (3 Cir.) cert. den. 329 U.S. 731 (1946)(TB 26-27), public interest required subsidiaries and affiliates to be brought into the parent's reorganization for treatment as a single transportation system. The statement, "the corporate fiction can be given effect in some instances and with perfect consistency disregarded in other instances." (155 F.2d at 484) referred to individual cases not to particular situations within each case. It is no more than a way of saying that whether consolidation may or should be had in the first instance depends on the particular facts in each case.

In no sense did the court hold or suggest that once consolidation is decreed its incidents and consequences may apply to some creditors and not to others. This is the question in the instant case, not whether there should be a consolidation. In the instant case, that question arises upon provisions of a

plan and the Pittsburgh court emphasized, "we are in no way passing upon the fairness of a plan" (155 F.2d at 485) which is not even described in the opinion.

In Anaconda Building Co. v. Newland, 336 F.2d 625 (9 Cir. 1964), (TB 27-29) consolidation was denied. The trustee's statement to the contrary (TB 27) is in error. The propriety of a selective consolidation, exclusion of one or more creditors fromits natural consequences, was not decided. Denial of consolidation foreclosed the question.

In re Security Products Company, 310 F. Supp. 110 (E.D. Mo. 1969)(TB 29-31), parent and subsidiary were adjudicated bankrupt. Finding "sufficient reason * * for the administration upon the subsidiary's assets in the parent's bankruptcy proceedings", the court ordered the subsidiary's assets to be turned over for "administration" in the parent's bankruptcy. Clearly, this is a case of administrative not substantive consolidation. The subsidiary's assets remain its own, there is no hotchpot, "the corporate existence of the subsidiary is not being disregarded." 310 F. Supp. at 118 (emphasis court's).

Fish v. East, 114 F.2d 177 (10 Cir. 1940)(TB 31), In re Rieger, Kapner & Altmark, 157 Fed. 609 (S.D. Ohio 1907) and In re Eilers Music House, 270 Fed. 915 (9 Cir. 1921)(TB 32), like

Security Products, supra, are turnover cases, not in fact or by analogy substantive consolidations, corporate veils are not pierced. None of them afford the slightest support to the trustee's argument for consolidation as to some creditors and not as to others.

Of course the court has power to allow, disallow and reconsider allowed claims. Bankruptcy Act, section 2a(2) (TB 37-38). And there is no question of the equitable power to subordinate claims. Pepper v. Litton, 308 U.S. 295 (1939); Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941) (TB 38). The trustee does not seek disallowance, reconsideration or subordination of Talcott's claims. And here as in most cases, proper exercise not existence of the powers over claims is in issue.

Pepper and Sampsell are classic cases of family corporations used and manipulated in out-and-out fraud upon their creditors or upon creditors of their dominant officers whose claims were subordinated to the claims of the defrauded creditors as a measure of simple justice and equity. The trustee suggests no misconduct whatever on the part of Talcott - there is none - much less misconduct of the gravity in those cases, to justify, in the name of equity, subordination or imposition of any other sanction upon Talcott's valid lien claim.

In Vanston Bondholders Protective Committee v. Green, 329 U.S. 156 (1946)(TB 38-40), a claim for post-petition interest on interest was disallowed. The court did speak of balancing equities but it did so in the context peculiar to post-petition interest generally. The court reaffirmed the rule that validity of claims is determined as of petition filing and there was no pre-petition default which triggered the contractual provision for interest on interest. Hence, at petition filing there was no right to interest on interest. Here Talcott did at petition filing have a valid lien and disallowance of post-petition interest in Vanston has not the slightest bearing on Talcott's right to its lien.

The trustee asserts that Talcott relied on the separate security of each debtor. The implication is that to sustain its position Talcott must show reliance on the debtors' assets as a unit. There is no proof that Talcott relied on the security of each debtor. Nor is there proof that Talcott did or did not rely on the debtors' combined credit and assets. There has been no exploration of these particular equities of Talcott and of the other creditors.

In Chemical Bank New York Trust Company v. Kheel, 369 F.2d 845 (2 Cir. 1966), as the record there shows, a considerable part of the argument centered on which party's burden it was to

prove or disprove the Bank's reliance on the group as a unit. This court found it unnecessary to pass on this question. It conceded "the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others." Such possible unfairness, the court held, is disregarded in the interests of all creditors in the "rare case" where the hopelessly confused interrelationships cannot be unscrambled except at large expense of time and money with no assurance of success. Kheel was such a "rare case" and, as the concurrence of Judge Friendly noted, (369 F.2d at 848) creditors were not given an opportunity to show reliance or any other equities.

Assuming then that there is power to make consolidation applicable to some and not to others and that inclusion or exclusion depends on equities to be adequately explored on notice, the power is not exercised in the "rare case" such as Kheel. The instant case is exactly the same "rare case", as the findings conclusively demonstrate (40a-41a). Consequently, consolidation here must apply equally to all. Talcott may not be excluded.

In the light of Kheel, Stone v. Eacho, 127 F. 2d 284 (4 Cir.), rehearing denied 128 F. 2d 16, cert. denied 317 U.S. 635 (1942) (TB 32-33), Soviero v. Franklin National Bank of Long Island, 328 F. 2d 446 (2 Cir. 1964) and similar cases cited by the trustee for the exercise of power to exclude Talcott from

the consolidation, are not controlling.

Talcott's brief does not disclose whether Miller-Wohl and Lyntex are the "rare cases" like Kheel and like the instant case. If they are, they are in error and the provisions therein for protection of possible equities of individual creditors and for special notice of hearing are an unnecessary waste. If they are not the "rare cases", then they simply have no application and, in any event, in the instant case there was no notice and exploration of equities for Talcott or for anyone else.

Talcott's lien was "contingent or inchoate" (Tal. B 22). Liens for attorney's fees under terms of financing agreements, mortgages and other security instruments are also such liens. Security Mortgage Co. v. Powers, 278 U.S. 149 (1928) had this to say about a mortgage lien for attorney's fees:

> "The lien was not inchoate at the time of adjudication. It had already become perfect when the principal note and the loan deed securing it was given. Property subject to a lien to secure a liability still contingent at the time of bankruptcy is not discharged from the lien by the adjudication. The secured obligation survives; and if it is that of a third person, it is usually unaffected by the bankruptcy. When by the happening of the event the contingent liability becomes absolute, the lien becomes enforceable though this occurs after adjudication. ... The contingent obligation to pay attorney's fees was part of the original transaction. The consideration for the lien was not the attorney's services (after bankruptcy), but the $90,000.00 advanced by the Mortgage Company and this was a

present consideration. ..." 278 U.S. at 156.

Whether contingent or inchoate or perhaps both, the Supreme Court says Talcott's lien was part of the original transaction, it was fixed when the agreement was entered, it was supported by consideration of the agreement, it was valid at petition filing and thereafter, it became enforceable upon the happening of the event, namely, judicial discovery and adjudication, by consolidation, that Continental and Apco were one all along, that the property and debts of one were the property and debts of the other.

The trustee disagrees with the Supreme Court. He reads the dragnet clause out of the agreement. He maintains that Talcott never had and does not now have a lien of any kind. He urges that to recognize a lien for Talcott is to give it a windfall, something it did not bargain for.

Enforcement of Talcott's lien involves no equitable considerations and no balancing of equities is appropriate. If it were otherwise, all valid liens enforceable in bankruptcy proceedings would be subject to jeopardy by the indiscriminate charge of windfall.

It is a perversion of reality to say that to permit Talcott to enforce its lien would result in unjust enrichment prejudicial to the other creditors. To maintain this notion is nothing less than to destroy all secured transactions which, in

their very nature, accord secured creditors, to the extent of their security, a preferred position over others who "took their chances" of the debtor's "credit as unsecured creditors always do;...". Hollander v. Henry, 186 F. 2d 582 (2 Cir.) cert. den. 341 U.S. 949 (1951).

"Valid liens existing at the commencement of bankruptcy proceedings have always been preserved." Gardner v. State of New Jersey, 329 U.S. 565, 567 (1947). "It is the policy of the Act to allow secured creditors, those having liens upon the assets of the bankrupt to have their claims recognized first; and the Act does not seek to jeopardize this secured status except where that intent is clear." In re Trahan, 283 F. Supp. 620, 621 (D. La. 1968), affirmed 168 F. 2d 808, memorandum opinion; Continental Vending Machine Corp., et al, 491 F. 2d 813, 821. It is in accord with this policy of preserving and protecting pre-petition valid liens that failure to make them enforceable prior to bankruptcy by taking action prescribed under state law has been regularly excused in the bankruptcy courts and post-petition perfection approved. Lockhart v. Garden City Bank & Trust Co., 116 F. 2d 658 (2 Cir. 1940); American Coal Burner Co. v. Merritt, 129 F. 2d 314 (6 Cir. 1942); In re Luke County Fuel & Supply Co., 70 F. 2d 391 (7 Cir. 1934); In re Grosse, 24 F. 2d 305 (7 Cir. 1928); Poly Industries, Inc. v. Mozley, 362 F. 2d 453, 457-458 (9 Cir. 1966), c.d. 385 U.S. 958.

> "The local law should not be unreasonably construed to penalize secured creditors when no prejudice can result to any unsecured creditor. A contrary 'construction would enrich unsecured creditors at the expense of secured creditors, creating a windfall'. Lewis v. Manufacturers Nat. Bank of Detroit, 364 U.S. 603, 608-609... 'Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite'. Chemical Bank New York Trust Company v. Kheel...". In re Fried Furniture Corp., 293 F. Supp. 92, 93 (E.D.N.Y. 1968).

Nothing has been discovered in the legislative history of the various Chapters of the Act that militates in the slightest against an unyielding intent and policy of preserving and protecting valid liens. And §216 (7) of the Bankruptcy Act is the most explicit expression of this policy for Chapter X, an eloquent pronouncement that the policy favoring rehabilitation of corporations does not prevail over the policy as to liens in an economy where "Millions of dollars are daily lent upon... collateral,...". Matter of Hudson River Navigation Corp., 57 F. 2d 175, 176 (2 Cir. 1932).

Even if consideration of equities were in order, enforcement of Talcott's lien can hardly be said to prejudice creditors to any appreciable extent if at all. No plan is possible without consolidation. "Any plan...should provide for a merger of the assets and liabilities of the debtors...". (4a). Here, as in Kheel, consolidation makes a plan possible by achieving the following results:

"By the order of consolidation, in effect the intercompany claims of the debtor companies are eliminated, the assets of all debtors are treated as common assets and claims of outside creditors against any of the debtors are treated as against the common fund, eliminating a large number of duplicative claims filed against several debtors by creditors uncertain as to which debtor was eventually liable.

"This makes possible what has heretofore not been feasible, determination, allowance and classification by the trustee of claims of creditors..."

Creditors are saved the $300,000.00 expenditure necessary in attempt to unscramble the debtors' transactions with no assurance of success. Application of the $300,000.00 "surplus" against the $800,000.00 deficiency will pro tanto reduce Talcott's general claim and save the creditors the proportionate amount of dividend to which Talcott would otherwise be entitled. Measured against the large assets available for distribution and the large amount of claims (Record Document 11, pp. 40-47) the "surplus" is a pittance.

The trustee and creditors want the benefits of consolidation which makes the plan possible. Equity exacts a price for such benefits. It demands that the consequences of consolidation operate without discrimination as between secured and unsecured creditors, even if the secured creditors are thereby advantaged. Equality is the very essence of equity which attends bankruptcy administration.

The trustee simply cannot be allowed to treat Continental and Apco as one in order to reap the benefits of consolidation and at the same time treat them as separate entities for Talcott. The trustee's exemplary zeal and faithfulness in the discharge of his fiduciary obligations is commendable. The Chancellor cannot reward him when he "wants to dance without paying the music." Fitz-Patrick v. Commonwealth Oil Company, 285 F. 2d 726, 730 (5 Cir. 1960).

IV - CHEMICAL BANK V. KHEEL IS CONTROLLING

Kheel is not distinguishable. In the context, the distinction between Talcott's lien and the Government's priority is unimportant. That the lien is consensual and the priority is statutory is of no consequence. Security and priority both have to do only with a claims rank superior to general claims. Without consolidation, the Government had no right to extend its claim against the parent and its assets to the subsidiaries and their assets.

Consolidation in Kheel was for "purposes of these reorganziation proceedings and any ensuing proceedings under the bankruptcy laws" (Appellant's Appendix 4a). Pending the consolidation motion a plan was filed for liquidation and when consolidation was granted, a revised plan was filed on a consolidated basis (Trustee's Supplemental Brief 4-6). For all intents and purposes, consolidation was part of the plan as it is in the

instant case.

The arguments in Kheel were very much the same as in this case, particularly the Bank's assertion that the Government "did not bargain for" a claim against the subsidiaries (Appellant's Brief 23-24) and the Government's denial that it "will be unfairly benefited by consolidation". (Appellee's Brief 35 and 33-34). No differences are perceived between Kheel and this case to compel different results.

Talcott's Point IV (Brief 24) is withdrawn.

CONCLUSION

Talcott's possession of the "surplus" was from the beginning and it is now - lawful and there was never any obligation to return it. Consolidation worked a merger of Continental and Apco, of their assets and liabilities, rendering the debts of Continental the debts of Apco and, by virtue of the broad dragnet clause, consolidation extended Talcott's lien to Continental's debts. The court has no power to deprive Talcott of its valid lien either at law or in equity. Assuming power in appropriate cases to exclude a creditor from consolidation, this is not such a case and Talcott's exclusion is improper and invalid. Holding a valid secured claim, Talcott is "affected" by the plan, section 216(7) of the Act is

applicable and the plan is not fair and equitable within the meaning of section 221(2). The order appealed from should be reversed.

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